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RUEHMD/AMEMBASSY MADRID 3654
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C O N F I D E N T I A L SECTION 01 OF 03 LA PAZ 002981

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PASS TO EEB/ESC/IEC/EPC GLENN GRIFFIN

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SUBJECT: RESOURCE NATIONALISM IN BOLIVIA

REF: SECSTATE 150999

Classified By: Ecopol Chief Mike Hammer for reasons 1.4 (b) and (d).

Summary

11. (C) The Morales administration believes that the state should be more involved in all aspects of the Bolivian economy. In that context, resource nationalism does not stand alone; control of natural resources just happens to be the most valuable for the administration both financially and symbolically. The "nationalization" of Bolivia's gas remains a very popular move by the government and is seen by the majority of Bolivians as netting a large cash windfall for the nation. At present, it is unclear if the reality of falling production levels and lack of investments will push the government to establish a more stable judicial and economic environment or will only motivate them to take even more radical steps toward greater state control over the nation's resource wealth. End summary.

Gas "Nationalization"

12. (C) The Morales administration's May 2006 nationalization decree raised tax rates on production and called for the state petroleum company (YPFB) to gain control over "the entire hydrocarbons production chain" through majority ownership in key companies. The result has been additional revenue for the government (although most of the

trumpeted windfall is the result of price increases) and a climate of judicial and regulatory insecurity. The most glaring results of "nationalization" within the industry itself are, perhaps, the lack of investment that followed, the inability of Bolivia to meet its international contracts, and an ominous (thought slight for now) drop in production. (Note: Currently Bolivia is failing to deliver the minimum levels of gas on three out of its four major international contracts. End note.) The government now clearly realizes that it needs to attract additional investments, but as one industry expert put it "Bolivia is now akin to Lorena Bobbitt and the first thing we need to do is drop the knife!".

Winners and Losers

¶3. (C) The main beneficiary of "nationalization" was the Morales administration; the action was, and continues to be, very popular with the majority of Bolivians. After "500 years of exploitation" there is a thirst for control over national resources and even in the face of looming gas shortages and distribution problems with diesel and gasoline, the "nationalization" itself is still popular.

¶4. (C) The state has also benefited in the sense of increasing its role within the economy. However, this greater power and responsibility was not accompanied by any increase in institutional capacity. The attempt to centralize the entire production chain within the state has resulted in judicial uncertainty, frustration with government

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partners, and a lack of significant investments in all areas of the production chain. For example, despite a legal mandate to gain control over the gas transport company, Transredes, the state needs to acquire an additional 16% stake. Because of this, Transredes is stuck in legal limbo, unable to raise additional capital to carry out needed expansion projects. To whom would a bank be lending the money, the state or Transredes? Moreover, there is universal agreement in the industry that YPFB lacks the technical capacity to do the job assigned to it. Company executives complain that it is fine for the national company to assume a greater role, but they need someone competent to work with. The Norwegian Consul in La Paz, who is initiating a cooperation program to improve YPFB management, admitted that "the challenges are even bigger than we imagined." (Note: Encouraging Bolivia to work with third party governments like Norway and/or Spain could be one avenue for the USG to take to help curb radical resource nationalism in Bolivia. End note.)

The Mining Sector

¶5. (C) The Morales administration's February 9, 2007 nationalization of Glencore's Vinto tin smelter has yet to be followed by other forced nationalizations in the mining industry, although the state mining company (COMIBOL) has also "regained control" of the formerly cooperativist Huanuni mine. Vinto's nationalization may have been a special case (Note: Some observers suggest that Vinto's past ties to Evo's nemesis Gonzalo "Goni" Sanchez de Lozada prompted the smelter's nationalization. End note.) Yet, despite record prices, uncertainty in the mining sector has led to falling production levels.

¶6. (C) Evo's May 1 2007 declaration that Bolivia's national territory constituted a "state mineral reserve" has had little real impact on international companies yet, since subsequent decrees weakened the declaration and current mining concessions are not affected. U.S. mining executives inform us, however, that this decision has decreased their interest in exploration and investment in Bolivia, since increased national control over mining concessions could make

it difficult for companies to develop new projects in Bolivia.

¶7. (C) Of more concern to mining companies at the moment is the pending mining law (or mining code) which could include the requirement that all mining operations in Bolivia sign fifty-fifty joint ventures with the state (cooperativist mines may be exempted for political reasons.) Reportedly companies will have only one year from the promulgation of this law to sign joint venture contracts, and some observers suggest that this will result in "de facto" nationalizations if companies cannot make a profit giving up fifty percent control to the state (or if they do not want to accept the inefficiencies and potential liabilities of working closely with Bolivia's overstretched and understaffed state mining company.)

What's Next?

¶8. (C) Although our contacts in the mining ministry and

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COMIBOL insist that fifty-fifty joint partnerships are all that the state wants at this time, it is important to note that Evo's most popular action as president has been his "nationalization" of the hydrocarbons sector. As domestic issues such as rising inflation put pressure on his administration and his popularity, Evo may be tempted to initiate a propaganda power-play by sending troops onto mine sites the way he did with gas fields in May 2006.

¶9. (C) If Evo decides to nationalize parts of the mining sector, we expect to see graduated, "differentiated" nationalization. For political reasons, Evo is unlikely to nationalize deposits currently worked by cooperativist miners (since they are likely to protest in the streets of La Paz with dynamite.) Former Goni-properties (now owned by Swiss company Glencore) may prove tempting. Of the three large U.S. operations in Bolivia, Newmont's Inti Raymi mines are probably safest from nationalization, as they are low-grade, complex ore and are nearing the end of their mine life. Coeur D'Alene's San Bartolome mine is counting on close relations with cooperativist groups to deter government interest in nationalization. Apex's San Cristobal mine is most vulnerable, having just started production and facing financial difficulties due to proposed tax increases and potential changes to the import tax recovery system. San Cristobal executives assure us that they do not anticipate a forced nationalization. Other industry observers are less sanguine, however, and the high level of uncertainty in the sector as a whole is serving to limit exploration and investment interest in Bolivia.

Comment

¶10. (C) It is difficult to predict where the lack of investment and falling production levels across the natural resource industries will push the Morales Administration. They may see value in providing a clearer judicial operating environment and be rewarded with additional investment (recent Petrobras announcements of interest in further investments may signal this is the case) or more radical elements in the government may well blame the private sector for economic failings and seek outright nationalization (the October 2007 withdraw from the World Bank's International Center for the Settlement of Investment Disputes may signal this is the case). There is no love of the private sector in this administration and a struggle between their leftist ideology and the need to attract more investment is clearly taking place. To date, ideology has had the upper hand and while the long-term prospects for the economy have suffered, Evo's popularity has not. It is also worth noting that Morales may feel that countries such as Venezuela and Iran

offer him a viable alternative to private sector financing.

GOLDBERG